

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE INSPECTOR GENERAL**

**AUDIT OF
THE DISTRICT OF COLUMBIA
RETIREMENT BOARD**



**AUSTIN A. ANDERSEN
INTERIM INSPECTOR GENERAL**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General



March 4, 2005

Darrick O. Ross
Chairman
District of Columbia Retirement Board
1400 L Street, N.W., Suite 300
Washington, D.C. 20005

Betty Ann Kane
Executive Director
District of Columbia Retirement Board
1400 L Street, N.W., Suite 300
Washington, D.C. 20005

Dear Mr. Ross and Ms. Kane:

Enclosed is the final report summarizing the results of the Office of the Inspector General's Audit of the District of Columbia Retirement Board (OIG No. 03-1-22DY).

In commenting on our draft report, the District of Columbia Retirement Board (DCRB) took exception, partially or wholly, to five of our recommendations. As a consequence, DCRB did not consent to making definitive changes that would correct the problems identified in our report. Therefore, we consider these recommendations unresolved. Accordingly, we will continue to work with DCRB to reach final agreement on the unresolved recommendations. DCRB's final comments on the unresolved recommendations should be provided within 60 days of the date of this report.

DCRB's response to our findings and recommendations is synopsized after each finding. Our comments to DCRB's response follow. The full text of the DCRB response is included at Exhibit B.

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If you have questions, please contact William J. DiVello, Assistant Inspector General for Audits, at (202) 727-2540.

Sincerely,



Austin A. Andersen
Interim Inspector General

AAA/ws

Enclosure

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**AUDIT OF THE DISTRICT OF COLUMBIA
RETIREMENT BOARD**

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EXECUTIVE DIGEST

OVERVIEW

This report summarizes the results of the Office of the Inspector General's (OIG) Audit of the District of Columbia Retirement Board (DCRB) conducted under job code OIG No. 03-1-22DY. The audit objectives were to determine whether: (1) adequate controls, procedures, and oversight existed over the management of the Retirement Funds; (2) investments were sound, reasonable, and administered in accordance with laws and regulations; and (3) operations were efficient and effective.

CONCLUSIONS

On November 15, 2004, we met with DCRB officials to discuss the findings and recommendations contained in our draft report. Based on that meeting, we revised language contained in our draft report to clarify the findings and recommendations.

We concluded that DCRB's investments were sound, reasonable, and administered in accordance with laws and regulations, and DCRB's operations were efficient and effective. We also observed the Board of Directors (Board) conscientiously execute its fiduciary duties. However, we also concluded: (1) effective procedures and controls, such as criminal background checks, were generally not performed on DCRB trustees and staff to ensure compliance with the D.C. Code's prohibition against trustees and employees serving with certain criminal convictions; (2) executive staff did not consistently comply with DCRB's internal disclosure requirements and disclosure statements were not reviewed; and (3) DCRB had credit card accounts with limits far exceeding the yearly charges.

OTHER MATTER OF INTEREST

The Board of Directors is composed of 12 members, but only 11 members are currently serving on the Board. The unfilled Board position, which is reserved for a Council appointee, has been vacant since April 2003. Per the Executive Director, she has notified the Council of this vacant position on several occasions. The Board is responsible for overseeing two retirement funds with assets totaling \$2.4 billion, and therefore, we believe the Board should be at full-strength to comply with the D.C. Retirement Reform Act.

EXECUTIVE DIGEST

SUMMARY OF RECOMMENDATIONS

We directed six recommendations to the Executive Director to correct the deficiencies cited in the report. The recommendations focus on:

1. Establishing and implementing effective procedures, such as criminal background checks, for new trustees and employees to determine whether they have been convicted of any crime cited in D.C. Code § 1-744;
2. Conducting periodic checks, e.g., every two years, of incumbent fiduciaries and employees;
3. Maintaining adequate documentation to show criminal background checks have been conducted for the trustees and employees, and background checks have been conducted for the investment consultants and managers;
4. Pursuing adoption of an amendment to the Board's rules requiring executive staff to annually complete the OCF Financial Disclosure Statement;
5. Establishing procedures to ensure disclosure statements are properly and timely reviewed for possible conflicts of interest; and
6. Establishing travel and procurement credit card limits based on the actual and anticipated yearly usage rate.

A summary of potential benefits resulting from this audit is included at Exhibit A.

MANAGEMENT RESPONSE AND OIG COMMENTS

The OIG received a response to the draft report from the Chairman of the Board, DCRB, on January 19, 2005. DCRB took exception, partially or wholly, to our recommendations. For example, the DCRB did not think that the burden of ensuring that criminal background checks have been performed on trustees appointed by the Mayor and Council should be placed on DCRB. DCRB opined that the prohibition against individuals with certain criminal convictions serving as employees of the Board did not apply to staff employees. In response to our recommendations regarding DCRB's internal disclosure policies, DCRB stated that it will review its internal disclosure policy, but that the policy had been formulated similar to that of the Board of Elections and Ethics (BOEE), which does not review disclosure forms unless voted on by a majority of the members of BOEE. DCRB's response is included in its entirety at Exhibit B.

The OIG maintains its position in regard to its findings and recommendations. The OIG is of the opinion that DCRB should take the lead in ensuring that procedures and controls,

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such as criminal background checks, are in place to ensure that trustees and employees, are not in violation of the D.C. Code prohibition against persons with criminal backgrounds serving as employees or fiduciaries. We also continue to believe that internal financial disclosure forms should be reviewed if the policy requiring those forms to be completed is to be effective.

DCRB's response to our findings and recommendations is synopsized after each finding. Our comments to DCRB's response follow. The full text of the DCRB response is included at Exhibit B.

INTRODUCTION

BACKGROUND

DCRB Mission. DCRB's mission is to invest, control, and manage the D.C. Teachers' Retirement Fund and the D.C. Police Officers and Firefighters' Retirement Fund (Retirement Funds) assets. Unlike governing bodies of many other public employee retirement systems, the DCRB does not make benefit eligibility determinations or pension amount calculations, maintain benefit records, or process payments to beneficiaries. These duties are vested with several other District government agencies, including the Board of Education, the Police and Firefighters Retirement and Relief Board, and the Office of Pay and Retirement Services.

Legislative History. In November 1979, the U.S. Congress established DCRB as an independent District agency through enactment of the District of Columbia Retirement Reform Act (Reform Act), Pub. L. No. 96-122 (1979) (codified as amended at D.C. Code §§ 1-701 – 753 (2001)). The Reform Act provided DCRB with exclusive authority and discretion to manage and control the Retirement Funds and the Judges' Retirement Fund. The Reform Act also sets forth DCRB's structure, specific authority, and legal responsibilities.

Prior to the Reform Act, the federal government administered the Retirement Funds. When teachers, police officers, firefighters, and judges retired, the federal government paid their retirement benefits from general revenues instead of pre-funding the benefits throughout their careers. As a result, an unfunded liability totaling \$2.6 billion had accumulated by 1979. The District government assumed responsibility for this liability with the enactment of the Reform Act. By 1997, the unfunded liability had accumulated to approximately \$4.9 billion, which posed a significant strain on the District's financial resources.

The U.S. Congress enacted the National Capital Revitalization and Self-Government Improvement Act of 1997, Pub. L. No. 105-33, 111 Stat. 712 (1997) (codified as amended at D.C. Code §§ 1-803.01 – 817.07 (2001)) ("Revitalization Act") to provide relief to the District government. The Revitalization Act, which amended the Reform Act, significantly reduced the District's liability and administrative responsibility to certain retirement fund participants and beneficiaries. Among other things, the Revitalization Act amended the legislation that created the Judges' Retirement Fund and required the federal government to take full responsibility for administering the fund. The Revitalization Act saved the District \$250 million or more per year in total retirement plan contributions.

Retirement Plan Enrollment and Funding. Teachers and certain other educational employees are automatically enrolled in the Teachers' Retirement Plan when they begin their employment with the District. Likewise, police officers and firefighters are automatically enrolled in the Police Officers and Firefighters' Retirement Plan when they

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begin working for the District. The U.S. Treasury Department and/or the District government share the cost for providing the retirement benefits. The enrollees must also contribute a portion of their salary to help pay for their retirement benefits.

Board of Trustees and Staff. The Board of Trustees is composed of 12 members. The Mayor and the D. C. Council each appoint three Trustees to the Board. The active teachers, police officers, and firefighters each elect one Trustee, and the retired teachers, police officers, and firefighters each elect one Trustee.

DCRB is an independent personnel authority empowered to hire and terminate its staff in accordance with the District's Merit Personnel System (MPS). The MPS applies to DCRB staff in all respects except employee classification and compensation because the Board is statutorily granted exclusive authority to establish those policies for its staff. DCRB has 13 authorized staff positions, which includes 4 executive positions - Executive Director, Chief Investment Officer, General Counsel, and Director for Operations.

Operating Budget and Retirement Fund Assets. DCRB's operating budget is appropriated out of the Retirement Funds' investment earnings. The fiscal year (FY) 2003 operating budget was \$13.3 million, and the current operating budget for FY 2004 is \$13.8 million. At the end of FY 2003, the Retirement Funds' assets totaled \$2.4 billion.

Reporting Requirements. The Reform Act and Police Officers, Fire Fighters, and Teachers Retirement Benefit Replacement Plan Act of 1998 (codified as amended at D.C. Code §§ 1-901.01 – 911.04 (2001)) requires DCRB to publish an annual report. The annual report details the financial and actuarial status of Retirement Funds.

OBJECTIVES, SCOPE, AND METHODOLOGY

The audit objectives were to determine whether: (1) adequate controls, procedures, and oversight existed over the management of the Retirement Funds; (2) investments were sound, reasonable, and administered in accordance with laws and regulations; and (3) operations were efficient and effective. The audit covered FY 2003 through April 2004.

The OIG reviewed applicable laws and regulations, accounting and payroll documents, procurement documents, and other documents. In addition, the OIG interviewed DCRB staff, observed Board meetings, and benchmarked and researched current events involving other government retirement entities. We tested the validity and reliability of computer generated data by examining supporting documentation.

The audit was conducted in accordance with generally accepted government auditing standards.

INTRODUCTION

PRIOR AUDITS

In June 2004, we conducted an Audit of the Fiscal Year 2003 Agency Performance Measures and Agency Key Results Measures (OIG 04-1-03MA). The audit objectives were to: (1) verify the accuracy and reliability of performance data, and (2) determine whether agencies have implemented internal controls to prevent or detect material errors and irregularities in reporting performance measurements. We visited several District agencies, including the DCRB. We determined that DCRB reported accurate and reliable performance data, and had adequate internal controls.

We have not conducted any other audits at DCRB during the last 5 years. Additionally, we did not identify any audits conducted by the U.S. Government Accountability Office during this period. In accordance with the statutory requirement for an annual report, the DCRB engaged an independent qualified public accountant to conduct an examination of DCRB's financial statements for FY 2003. DCRB received an unqualified opinion on its FY 2003 financial statements.

AUDIT RESULTS

FINDING 1 - CRIMINAL BACKGROUND CHECKS

SYNOPSIS

Effective competent procedures, such as criminal background checks, were generally not performed on DCRB trustees and staff to determine whether a trustee or employee had been convicted of a crime delineated in the Reform Act. The Reform Act prohibits persons convicted of various crimes from serving as fiduciaries, or being hired as employees. Contributing factors to this condition were: the means by which an individual is appointed or elected a trustee; the lack of DCRB internal policies that mandate procedures such as criminal background checks of employees; and the lack of DCRB authority to review the backgrounds of appointed and elected trustees. As a result, DCRB could have possibly hired unqualified employees, and unqualified trustees could have possibly been appointed or elected to serve on the Board. The trustees and employees are responsible for investing, controlling, administering, and managing the Retirement Funds' assets totaling over \$2 billion and, thus, adequate safeguards should be in place to ensure that trustees and employees do not have criminal histories.

CRITERIA

The Reform Act does not allow persons convicted of various crimes to serve as fiduciaries, or be hired as Retirement Fund employees. D.C. Code § 1-744 (2001). The Reform Act provides:

No person who has been convicted of, or has been imprisoned as a result of his conviction of robbery, bribery, extortion, embezzlement, fraud, grand larceny... a felony violation of federal or state law involving substances defined in § 102(6) of the Comprehensive Drug Abuse Prevention and Control Act of 1970... any crime described in § 9(a)(1) of the Investment Company Act of 1940... a violation of any provision of this chapter ... or conspiracy to commit any such crime or attempt to commit any such crime, or a crime in which any of the foregoing crimes is an element, shall serve or be permitted to serve: (1) As a fiduciary, investment counsel, agent, or employee of any Fund established by this chapter; or (2) as a consultant to any Fund established by this chapter....

D.C. Code § 1-744(a)(2001).

AUDIT RESULTS

DISCUSSION

Internal Background Checks. DCRB staff included 12 employees, and 11 trustees served on the Board. However, the DCRB did not have in place internal procedures, such as criminal background checks, to determine whether employees had criminal backgrounds.

In calendar year (CY) 2003, DCRB hired four employees on whom it conducted reference checks. However, DCRB did not conduct criminal background checks to determine if the employees had been convicted of any crime cited in D.C. Code § 1-744. Although reference checks are effective in evaluating prospective employees, reference checks will not disclose if prospective employees have been convicted of crimes.

The General Counsel stated that he believed that the DCRB conducted background checks on the executive staff when they were hired. However, three of the four executives were hired prior to 2000, and DCRB only had documentation indicating a criminal background check for one executive (the Executive Director), who was hired in November 2002. The Board hired a consultant firm to assist the Board in selecting an Executive Director, and the Board required the consultant to conduct a criminal history check for the prospective candidates, as well as verify their credentials and employment, and review their credit histories.

The Mayor and City Council each appoint three trustees. In addition, active teachers, firefighters, and police officers each elect a trustee, as do retired teachers, firefighters, and police officers. A DCRB official informed us that elected trustees complete affidavits indicating that they have not been convicted of crimes. However, affidavits are not effective controls for detecting whether someone has a criminal background, which would disqualify the individual from serving as a trustee.

External Background Checks. DCRB officials stated that DCRB conducted background checks on the current investment consultants and managers. DCRB staff had access to Westlaw, which allows users to obtain public record information regarding investment firms and partners. Per the General Counsel, Westlaw searches are conducted on the investment firms and on the principal partners involved in managing DCRB investments. However, we were unable to verify that these checks had been conducted for the current investment consultants and managers because DCRB could not provide documentation.

The General Counsel stated that the former Associate General Counsel, who left in July 2003, performed the background checks. However, the General Counsel did not know whether the former employee maintained documentation of the completed checks. Another employee is now responsible for conducting the background checks.

During our fieldwork, DCRB was in the process of hiring an investment manager, and DCRB staff provided documentation showing searches had been conducted on the prospective

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investment firms. Documentation showing background checks have been conducted on the investment consultants and managers should be maintained to show due diligence.

Although the law states that persons with certain criminal convictions are prohibited from serving as fiduciaries or employees, the law does not address what means should be employed to detect such backgrounds or who bears such responsibility for making such determinations. An inference could be made that the Mayor and City Council bear such responsibility for trustees they appoint and the DCRB bears responsibility for employees hired. However, it is not certain who bears such responsibility for elected trustees. Therefore, we believe that the DCRB should meet with representatives of the Mayor's Office and the City Council to determine what effective procedures, such as criminal background checks, should be in place to ascertain that trustees are in compliance with D.C. Code § 1-744 (2001) and who bears responsibility for executing such procedures.

RECOMMENDATIONS

We recommended that the Executive Director, DCRB take action to:

1. Establish and implement effective procedures, such as criminal background checks, for new trustees and employees to determine whether they have been convicted of any crime cited in D.C. Code § 1-744.
2. Conduct periodic checks, e.g., every two years, of incumbent fiduciaries and employees.
3. Maintain adequate documentation to show criminal background checks have been conducted for the trustees and employees, and background checks have been conducted for the investment consultants and managers.

MANAGEMENT RESPONSE

DCRB partially agreed with the first finding in that it considered it reasonable that DCRB meet with representatives of the Mayor and the City Council to determine what procedures, such as criminal background checks, should be in place to determine that trustees are in compliance with the D.C. Code and to determine who bears responsibility for executing such procedures. However, the DCRB stated that the first recommendation improperly placed the burden on the DCRB to conduct criminal checks, whereas it should be the responsibility of the Mayor and the City Council to conduct background checks of trustees they appoint. In regard to trustees elected by teachers, firefighter and police, DCRB states that it could require such trustees to submit notarized statements affirming they are eligible to serve as trustees.

As for DCRB's staff, other than those appointed in a fiduciary capacity, DCRB stated that it has limited responsibility to conduct criminal background checks. DCRB's response

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included a discussion of the Employee Retirement Income Security Act of 1974 (ERISA) and how certain provisions of ERISA are identical or similar to provisions of the D.C. Code as it relates to the Reform Act. Basically, DCRB's discussion of ERISA focused on the use of the term "employee" by ERISA. DCRB states that the OIG erroneously interpreted the use of the term "employee" by concluding that it is applicable to staff employed by the Board. DCRB states that legislative history of the Reform Act provides guidance that "employee" was not intended to mean staff appointed by the Board. DCRB's response further states that the term "employee of any Fund" was meant to apply to the class of individuals with decision making authority such as the Board's custodian, money managers, or other fiduciaries

Regarding recommendation number 2, DCRB states that D.C. Code § 1-744 expires five years after an individual is convicted or released from prison. Therefore, the trustee or staff person would have been exempt from such background checks. Furthermore, periodic checks would be burdensome and costly.

Regarding recommendation number 3, DCRB states that it has maintained adequate documentation on criminal background checks.

OIG COMMENTS

With respect to recommendation number 1, the OIG adheres to its position that DCRB needs to take action to ensure that trustees and staff are not in violation of D.C. Code § 1-744, which prohibits individuals who have been convicted of certain crimes from serving as trustees or fiduciaries. We believe that DCRB should take the lead in meeting with representatives of the Mayor and the City Council in determining what procedures should be in place to ensure that no trustee or employee is in violation of the law.

As stated above, DCRB takes exception to the OIG position that D.C. Code § 1-744 applies to DCRB staff employees. In fact, DCRB goes on at length to point out that "employee" and "fiduciary" are not separate terms and that "employee" refers to consultants employed by DCRB and not staff hired by DCRB. DCRB cites ERISA as guidance for the Reform Act and states that ERISA identifies individuals and entities which would qualify as fiduciaries. Furthermore, DCRB states that legislative history provides guidance on the legislative intent that the term "employee" was not meant to mean "staff appointed by the Board."

However, the OIG found nothing in the legislative history to indicate that Congress intended "employee" as referred to in D.C. Code § 1-744(a) to mean one who has discretionary authority or control over a retirement fund, which defines a "fiduciary." *See* D.C. Code § 1-702(20)(A)(Supp. 2004). Secondly, D.C. Code § 1-744(a) cites the terms "fiduciary" and "employee" disjunctively, as separate classes of individuals, e.g., administrator, fiduciary, investment counsel, agent, *or* employee of the Fund.

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We note that the Reform Act defines an individual who exercises discretionary authority or control over management, disposition, or administration of the Fund as a fiduciary, not an employee. The Reform Act, however, does not define “employee,” but ERISA defines the term as “any individual employed by an employer.” 29 U.S.C. § 1002(2)(A). Like the Reform Act, ERISA refers to classes of individuals, disjunctively, e.g., “an administrator, fiduciary, officer, trustee, custodian, counsel, agent, employee, *or* representative” 29 U.S.C. § 1111(a). Hence, “employee” and “fiduciary” are separate classes of individuals.

DCRB also states that the D.C. Code imposes a penalty on the individual who violates the provision regarding criminal backgrounds rather than DCRB. Therefore, DCRB contends that the burden of compliance is not with DCRB but with the individual. DCRB goes on to say that if the legislature had “intended for the Board to take affirmative steps . . . to preclude such person from serving in such function,” such function could have been included in the D.C. Code.

However, we note that D.C. Code § 1-744(a) states that no one who has been convicted of certain crimes “shall serve or be *permitted to serve*” as a fiduciary, investment counsel, etc., of the Fund. Because the DCRB alone appoints its staff pursuant to D.C. Code § 1-711(g)(20), DCRB itself may not permit anyone it has hired to serve as a fiduciary, employee, etc. if that person has been convicted of one of the enumerated crimes.

Irrespective of the criminal conviction prohibition in the D.C. Code, having policies and procedures in place to prevent individuals with criminal backgrounds from becoming employees or fiduciaries is a good management control. Controls over the safeguarding of resources ensure that assets are protected against loss or misuse. Because DCRB is responsible for safeguarding and investing over \$2 billion in assets, having criminal background checks performed on its staff is a good management control. The OIG asserts that it is the responsibility of District agencies, whether independent or subordinate to the Mayor, to take affirmative or proactive measures to ensure that effective management controls are in place, regardless as to whether or not such controls or procedures are specifically required by law or regulation.

With respect to recommendation number 2, the OIG maintains its position that periodic checks be performed on employees and trustees to detect any possible criminal conviction subsequent to an individuals becoming a trustee or employee. In regards to recommendation number 3, the OIG maintains its position that DCRB should have on file documentation that criminal background checks have been performed on trustees and employees. For example, if background checks were conducted by the Mayor’s Office or the City Council, DCRB should request copies for their files.

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FINDING 2 - FINANCIAL DISCLOSURES

SYNOPSIS

Two executive staff persons did not consistently comply with DCRB's internal disclosure requirements, although they have significant administrative and managerial responsibilities, including providing investment advice and interacting with consultants and contractors. We attributed this condition to a need for increased management oversight. In addition, no one reviewed the completed disclosure statements to determine whether a conflict of interest existed. As a result, DCRB staff may have had conflicts of interest that were not detected.

BOARD DISCLOSURE REQUIREMENTS

Personal Financial Disclosures. The Reform Act provides:

Each member of the Board shall, within 90 days of his selection as a member of the Board and not later than April 30th of each year thereafter, submit to the Mayor, the Council, the Speaker, and the President pro tempore a personal financial statement with respect to the preceding calendar year. Such statement shall be in such form as the Council may by regulation require and shall contain such information with respect to the member's financial condition as the Council may by regulation require....

D.C. Code § 1-731(a)(1)(2001).

The trustees must disclose their income sources, liabilities, interests in financial institutions, and other information.

Activities Sponsored by Service Providers. The Reform Act further provides that:

The Board may participate in seminars, conventions, dinners, or similar activities at the expense of a bank, investment manager, brokerage firm, or other entity only if the principal purpose of the activity is to discuss financial matters for the benefit of the participants and beneficiaries of the Fund and the activity is of a nature normally provided free of charge to other institutional investors. Participation in the activities in accordance with this paragraph shall not constitute a violation of subchapter XVIII of Chapter 6 of this title. The Board shall provide a list of these activities, indicating the sponsor and date of each activity, as part of the annual report provided for in § 1-732.

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D.C. Code § 1-711(c)(4)(2001).

DCRB has also implemented internal procedures requiring Trustees to obtain the Board's approval when outside parties (including entities conducting business or seeking to conduct business with the agency) pay for activities. Section I.A. of the *DCRB Procedures Manual* provides, in part:

The Board must approve Trustee education and related travel in the following circumstances:

- (1) Any of the education or related travel expense is paid in whole or in part by an outside party, including but not limited to entities who are doing business with the Board or who might seek to do business with the Board.

Financial Disclosure Statement. The D.C. Campaign Finance Reform and Conflict of Interest Act of 1974 as amended, requires the Board members to complete the Office of Campaign Finance's (OCF) Financial Disclosure Statement (D.C. Code § 1-1106.02). The Trustees must disclose their financial interests, income sources, and other information.

STAFF DISCLOSURE REQUIREMENTS

Activities Sponsored by Service Providers. DCRB's internal procedures also require staff to obtain the Board's approval when outside parties pay for activities. Section I.A. of the *Procedures Manual* provides, in part:

Prior Board approval of education and related travel by the staff, including by the Executive Director, must be obtained in the following circumstances:

- (1) Any of the education or related travel expense [] is ... paid in whole or in part by an outside party, including but not limited to entities who are doing business with the Board or who might seek to do business with the Board.

Financial Disclosure Statement. The D.C. Campaign Finance Reform and Conflict of Interest Act of 1974 as amended, also requires the Executive Director, and the General Counsel to also complete the OCF Financial Disclosure Statement (D.C. Code § 1-1106.02). The Executive Director, and General Counsel must disclose their financial interests, income sources, and other information.

Although the Act does not require the Chief Investment Officer and the Director of Operations to complete the statement, the Board adopted a motion in April 2001, requiring

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these two executive staff persons to also complete the statement. The motion did not require anyone to review the disclosure statements and determine whether a conflict of interest existed. Instead, the motion simply required these statements to be filed internally and be available for Trustee use.

DCRB's "Conflict of Interests Guidelines" provide:

All staff members shall also be required to annually disclose, in writing, all loans, stocks, bonds, options, or any other financial interest or liability that has been acquired from a service provider or fiduciary of the Fund. Staff shall make such disclosures to the Executive Director and the Chairman of the Board, and the Executive Director shall make such disclosure to the Board.

DISCUSSION

The Trustees and DCRB executive staff must abide by several annual disclosure requirements to ensure conflicts of interest do not exist and to protect the Retirement Fund assets. Our review disclosed: (1) the Trustees completed their annual disclosure requirements, and disclosed their activities sponsored by service providers; and (2) the Board of Trustees approved the activities sponsored by outside entities, as required. However, our review also disclosed that two executives did not consistently complete the OCF Financial Disclosure Statement, and no one reviewed the disclosure statements to determine whether a conflict of interest existed.

Staff Disclosures. The Executive Director, General Counsel, Chief Investment Officer, and the Director of Operations all have significant administrative and managerial responsibilities, including providing investment advice and interacting with consultants and contractors. As such, the Board adopted its motion requiring all executive staff to complete the OCF Financial Disclosure Statement.

Although it has been 3 years since the Board adopted the motion, the Chief Investment Officer and the Director of Operations did not complete the OCF Financial Disclosure Statement in CY 2003 for CY 2002. The Executive Director and General Counsel completed their disclosure statements, as required. We noted the Chief Investment Officer completed the disclosure statement for CYs 2000 and 2001, and the Director of Operations completed the disclosure statement for CY 2000.

The Executive Director and the General Counsel stated that the Board's motion requiring these two executives to complete the disclosure statement had not yet been included in the DCRB's rules. The Executive Director also stated that when she became the Executive Director, she concluded that these two executives should not complete the OCF Financial Disclosure Statement "until adoption of an amendment to the Board [r]ules with clarifying details." As a result of our review, the Executive Director submitted a letter, dated

AUDIT RESULTS

February 25, 2004, to the Chief Investment Officer and the Director of Operations requiring them to complete the disclosure statement for CYs 2002 and 2003.

Disclosure Review. No one reviewed the disclosure statements completed by the Chief Investment Officer and the Director of Operations for CYs 2000 and 2001 to determine whether a conflict of interest existed. In fact, one disclosure statement was in an envelope that was apparently never opened. If the disclosure statements are not reviewed, a conflict of interest could exist and not be detected.

When the Board adopted the motion requiring all executive staff to complete the disclosure statement in April 2001, the Board agreed to follow the same procedures as the OCF. At the Board meeting, one Trustee stated that the OCF did not open the statements unless a complaint was filed. However, this statement is inaccurate. The OCF reviews disclosure statements for accuracy and timeliness when the statements are received. Also, according to an OCF staff member, the disclosure statements are public documents once the OCF completes its review.

RECOMMENDATIONS

We recommended that the Executive Director, DCRB:

4. Pursue adoption of an amendment to the Board's rules requiring executive staff to annually complete the OCF Financial Disclosure Statement, and
5. Establish procedures to ensure disclosure statements are properly and timely reviewed for possible conflicts of interest.

MANAGEMENT RESPONSE

In its response, DCRB states that the intent of its internal policy requiring senior staff to complete financial disclosure forms was for its general counsel to keep these forms in custody until/unless a request for examination and audit by a trustee. DCRB stated that its internal policy was similar to requirements imposed on trustees by the Conflict of Interest Act. DCRB further states that Office of Campaign Finance (OCF) Financial Disclosure Statement (Form 62) is kept in the custody of the director of the Board of Elections and Ethics (BOEE) for 4 years, or until forms are requested and approved for review by the BOEE. The response further states that the BOEE would only look at the disclosure forms after a majority of members of the BOEE had voted for a review, in accordance with the D.C. Code.

DCRB further stated that DCRB's rules will be undergoing a comprehensive review during the coming months and will result in recommended language to clarify and incorporate internal policy for senior staff disclosure.

AUDIT RESULTS

OIG COMMENTS

DCRB's comments regarding the BOEE imply that no one looks at the OCF financial disclosure statements once they are received in the OCF. However, OCF, a subordinate unit of BOEE, does review these statements.

The general counsel for OCF informed the OIG that the OCF is charged with reviewing the financial disclosure statements. The OCF auditor reviews Form 62s when they arrive at OCF. Based on the results of this review, the OCF auditor forwards the forms to the OCF general counsel. If the general counsel finds a possible conflict in a Form 62, the general counsel notifies the employee to take corrective action to eliminate the possible conflict. Hence, contrary to DCRB's contention, Form 62's are reviewed.

Having an internal policy in place to require senior officials to complete financial disclosure statements is a good management control implemented by DCRB. And the OIG understands DCRB's concern for its employees' privacy. However, to hold the disclosure statements in custody without reviewing them reduces the effectiveness of the management control. Conflicts could exist and go undetected, unlike at OCF where processes exist to detect conflicts.

The corrective action cited by DCRB partially addresses recommendations four and five, but the OIG strongly believes that the internal disclosure statements need to be reviewed rather than just held in custody.

AUDIT RESULTS

FINDING 3 - CREDIT CARD LIMITS

SYNOPSIS

DCRB had two travel credit card accounts and one procurement credit card account with limits far exceeding the yearly charges. This condition existed due to the need for management emphasis on maintaining reasonable credit card limits. As a result, the DCRB exposed itself to unnecessary risks. If the credit cards are lost, stolen or inappropriately used, the potential exists for excessive fraudulent charges. For internal control purposes, the credit card limits should be reasonable and in-line with the actual yearly charges.

DISCUSSION

DCRB credit cards, which were issued under General Services Administration contracts, are used to pay for employment-related travel expenditures, education, and other expenditures. Our review disclosed the DCRB: (1) had adequate written credit card procedures; (2) maintained adequate documentation to support the expenditures; (3) used the credit cards to pay for authorized expenditures; and (4) timely paid the credit card balances in full and avoided finance charges. However, our review also disclosed that DCRB had credit card limits far exceeding the yearly charges.

Travel Card Limits. DCRB had two travel card accounts – one account used by the Travel Coordinator and one account used by the Board members and staff. Only one Trustee and two executive staff persons had individual credit cards under the latter account. For accountability purposes, the three persons had different credit card numbers under the account. The travel cards were used to pay for travel expenses, including airline and train fares, hotel and lodging costs, and rental car fees.

DCRB only charged approximately \$38,000 to the two travel card accounts in FY 2003. However, the travel card limit for each account was \$9.9 million in the beginning of the year. Although DCRB later reduced the limit to \$250,000 in July 2003, we believe this limit is also too high based on the yearly charges. In addition, we believe this limit is too high based on the budget. The reduced travel credit card limit exceeded the FY 2003 budget for both education and travel by \$50,000.

Procurement Card Limits. DCRB has one procurement card account. The procurement card was used to pay for training and conference fees. In addition, the procurement card was used to pay for other expenditures made pursuant to the procurement rules and approved by the Executive Director. DCRB staff informed us that the procurement card, as well as the travel card used by the Travel Coordinator, is kept in a locked safe.

AUDIT RESULTS

In FY 2003, the DCRB only charged approximately \$15,000 to the procurement card. However, the procurement credit card limit in FY 2003 was \$75,000. We believe this limit is too high based on the yearly charges.

RECOMMENDATION

We recommended that the Executive Director, DCRB:

6. Establish travel and procurement credit card limits based on the actual and anticipated yearly usage rate.

MANAGEMENT RESPONSE

DCRB responded that it has already taken action to establish credit card limits based on actual and anticipated usage.

OIG COMMENTS

Corrective action taken resolves the finding.

EXHIBIT A

**SUMMARY OF POTENTIAL MONETARY BENEFITS
RESULTING FROM AUDIT**

Recommendation	Description of Benefit	Amount and Type of Monetary Benefit	Status¹
1	Compliance and Internal Controls. Establish and implement procedures, such as criminal background checks, for new trustees and employees.	Non-Monetary	Unresolved
2	Compliance and Internal Controls. Conduct periodic checks, e.g., every two years, of incumbent employees and fiduciaries.	Non-Monetary	Unresolved
3	Compliance and Internal Controls. Maintain adequate documentation to show criminal background checks have been conducted for Trustees, employees, and investment managers and consultants.	Non-Monetary	Unresolved
4	Compliance and Internal Controls. Pursue adoption of an amendment to the Board's rules requiring all executive staff to annually complete the OCF Financial Disclosure Statement.	Non-Monetary	Unresolved
5	Compliance and Internal Controls. Establish procedures to ensure disclosure statements are properly and timely reviewed for possible conflicts of interest.	Non-Monetary	Unresolved

¹This column provides the status of a recommendation as of the report date. For final reports, “**Open**” means management and the OIG are in agreement on the action to be taken, but action is not complete. “**Closed**” means management has advised that the action necessary to correct the condition is complete. “**Unresolved**” means that management has neither agreed to take the recommended action nor proposed satisfactory alternative actions to correct the condition.

EXHIBIT A

**SUMMARY OF POTENTIAL MONETARY BENEFITS
RESULTING FROM AUDIT**

Recommendation	Description of Benefit	Amount and Type of Monetary Benefit	Status¹
6	Internal Controls. Establish travel and procurement credit card limits based on the actual and anticipated yearly usage rate.	Non-Monetary	Closed

EXHIBIT B

MANAGEMENT RESPONSE

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January 19, 2005

Mr. Austin A. Andersen
Interim Inspector General
Office of the Inspector General
Government of the District of Columbia
717 14th Street, N.W.
Washington, D.C. 20005

Re: Draft Report of Inspector General's Audit (OIG No. 03-1-22DY)

Dear Mr. Andersen:

I am writing on behalf of the D.C. Retirement Board ("Board") in response to the revised draft report summarizing the results of the Office of the Inspector General's Audit (OIG No. 03-1-22DY). The response provides background information regarding Trustee responsibilities and the law that governs such responsibility. Following the brief background, this response will address findings #1 and #2 and related recommendations. The Board appreciates your inclusion of this response in the final audit report.

Background

The Employee Retirement Income Security Act of 1974 ("ERISA") is a well known Federal law enacted by the U.S. Congress applicable to private employer retirement programs. One of the key features of ERISA is the identification of individuals and entities that are fiduciaries with respect to plans covered by ERISA, and the description of responsibilities placed on plan fiduciaries. Another important feature of ERISA is the requirement that all plans be governed by written documents, and that fiduciaries adhere to the terms of the documents and instruments that govern the plan ("plan documents").

Public sector or governmental plans, like the retirement program for District police officers, fire fighters and teachers ("D.C. plans"), are regulated by State and/or local laws.

EXHIBIT B

MANAGEMENT RESPONSE

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Although ERISA is not directly applicable to the D.C. plans, the provisions under Chapter 7 of the District of Columbia Official Code that govern the operations of the D.C. plans impose similar if not identical requirements on its Trustees (i.e., the “D.C. Retirement Board,” or “Board”). As correctly noted in the Revised Draft Report, the District of Columbia Retirement Reform Act, as amended (the “Reform Act”),¹ was enacted by the Congress in 1979 to establish the D.C. Retirement Board and to govern its operations. The Reform Act is the “plan document” that establishes the terms to which Board members, who are named fiduciaries, must adhere.

OIG Finding 1 - Criminal Background Checks

The Reform Act [D.C. Official Code § 1-744 (§ 1-744)] prohibits persons who have been convicted of a wide range of crimes including robbery, bribery, extortion, and fraud, from serving within 5 years of such conviction as: (1) a *fiduciary*, (2) *investment counsel, agent*, or (3) an “*employee of any Fund established under this chapter*” (i.e., Police Officers and Fire Fighters’ Retirement Fund and the Teachers’ Retirement Fund established under D.C. Official Code §§ 1-712 and 1-713 respectively).

The Revised Draft Report (OIG No. 03-1-22DY) correctly identifies a major deficiency in § 1-744 by stating that “the law does not address what means should be employed to detect such backgrounds or who bears such responsibility for making such determinations.” The Revised Draft Report however fails to correctly interpret the statutory reference to “*employee of any Fund established by this chapter*” under § 1-744 by erroneously concluding that it is applicable to Board employees or staff appointed by the Board. This interpretation error consequently led to an incorrect assumption that the Board has an obligation to conduct criminal background checks for all staff hired by the Board. The following analysis will address the applicability of § 1-744 to employees of the Funds.

Employees

The requirement that an “*employee of any Fund established by this chapter*” under § 1-744(a) be precluded from serving as such if convicted and/or imprisoned for the commission of a wide range of criminal acts was not intended by the Congress to apply to *staff appointed*

¹ D.C. Official Code § 1-711 et al.

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by the Board. “Staff appointed by the Board” is a term of art used throughout the Reform Act to describe employees of the Board. This term is found in two separate provisions under Chapter 7.² Contrary to the Revised Draft Report interpretation, the legislative history provides guidance on the legislative intent that the term “employee” in § 1-744 was not intended to mean “staff appointed by the Board.”

When the Congress considered legislation to establish the D.C. Retirement Board to manage the assets of the retirement funds for certain District employees, it did so with the clear intention to require the Board to manage the funds under the same fiduciary standards enacted by Congress for private pension plans under ERISA.

“The [Congressional] committee felt that to insure sound management of the funds, reporting, disclosure, and fiduciary standards enacted by Congress for private pension plans (ERISA) should be applied to the District of Columbia’s pension plans.” [H. Rpt. No. 96-155, at 9 (1979)]

The intent of the Congress when enacting this provision was to prohibit persons who have been convicted of the crimes cited to serve in any capacity that involves decision making authority, custody or control of the Funds, as stated in Section 411(a) of ERISA. The clear intent of Section 411(a) of ERISA, which is almost identical to § 1-744, is that persons with discretionary authority with respect to the Funds should be precluded from serving in a capacity of trust for the funds if such person has been convicted of any of the cited crimes. The term “employee of any Fund established under this chapter” was understandably intended by Congress to apply to the class of individuals or entities with decision making authority, such as the Board’s custodian, money managers or other fiduciaries.

“Corporations and partnerships are subject to the preclusion from *employment* or affiliation with the funds only after notice and hearing by the Board of Parole and determination that it would be inconsistent with the intent of the bill to *employ* such organizations.” (Emphasis added) [H. Rpt. No. 96-155, at 20 (1979)]

Further, § 1-744(b) penalizes the individual or entity who willfully (knowingly or deliberately) violates this provision, and not the Board. The term “willfully,” when used in a criminal context denotes an act done intentionally, knowingly, and purposely, without

² D.C. Official Code §§ 1-711(g)(2) and 1-711(k)

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justifiable excuse. Since the sanctions under § 1-744(b) are only imposed on individuals who “willfully” violate this section, the burden, therefore, is on the individual who has knowledge of the criminal conviction to decline to serve in a capacity with the Funds that would be prohibited. The application of this sanction is clear evidence that the burden of compliance with this section is not placed on the Board, but rather the individual hired as custodian or otherwise in control of the Funds, or in a decision making capacity with respect to the Funds. Had the legislature intended for the Board to take affirmative steps (i.e., conduct criminal background checks) to preclude such person from serving in such function, it could have easily included such requirements among the many affirmative fiduciary duties prescribed in detail under § 1-741. The legislature could have also levied the sanction on the Board for permitting such individual to serve in the first instance.

With respect to Board employees (staff appointed by the Board), only one individual has delegated authority from the Board to perform in the decision making capacity of a fiduciary. That individual serves as Executive Director to the Board. As correctly noted in the Revised Draft Report, a criminal background check was conducted for the current Executive Director who was appointed by the Board in 2002. The previous Executive Director (J. Morales) served as a Board employee continuously from 1980 before becoming Executive Director in 1997. The 5-year prohibition had long expired before his 1997 appointment as Executive Director.

The Executive Director appointed prior to Mr. Morales (J.M. Cullins) had similarly served as a Board employee and General Counsel for 10 consecutive years prior to her appointment as Executive Director. During her entire tenure with the Board, she was a member in good standing of the D.C. Bar. Under the D.C. Bar rules of Professional Responsibility, any attorney convicted of a criminal offense involving moral turpitude is subject to disbarment. The severe sanctions imposed by the D.C. Bar on attorneys who are convicted of crimes of moral turpitude, in conjunction with Ms. Cullins’ continuous status as a member in good standing of the D.C. Bar made the prohibition in § 1-744, and the need for a criminal background check for her moot as well.

Investment Consultants and Managers

As noted in the Revised Draft Report, the Board’s staff regularly conducts background checks, via Westlaw, for fiduciaries including investment managers and consultants. It should also be noted that a prerequisite for an investment manager or consultant to be

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employed by the Board, is that such entity must be registered under the Investment Advisers Act of 1940 (15 U.S.C. § 80b-1 et seq.) (the “Advisers Act”), or a bank or trust company exempt from such registration. In either case, strict Federal regulatory requirements, along with numerous interpretations of the U.S. Securities and Exchange Commission (SEC) staff impose an enormous number of requirements on the operations and activities of such registered companies. These requirements and the rigorous disclosure process which includes disclosure of any criminal conviction of any individual officer, director, partner or owner of the entity effectively serve as an effective safeguard as any independent criminal background check the Board could conduct. These investment managers and consultants, whether registered or not under the Advisers Act, are subject to stringent fiduciary requirements that make it unlawful for them to engage in fraudulent, deceptive or manipulative conduct, and requires them to make full and fair disclosure of all material facts under Federal and state law.

Recommendations

We recommend that the Executive Director, DCRB take action to:

1. **Establish and implement effective procedures, such as criminal background checks, for new trustees and employees to determine whether they have been convicted of any crime cited in D.C. Code § 1-744.**

Under the “Discussion” of Finding #1, the Revised Draft Report reasonably recommends that the Board meet with representatives of the Mayor’s Office and the City Council to determine what effective procedures, such as criminal background checks, should be in place to ascertain that trustees are in compliance with D.C. Code § 1-744 and to determine who bears responsibility for executing such procedures. Under “Recommendations” however, the Revised Draft Report charges the Executive Director, DCRB to “take action” to establish and implement procedures including criminal background checks for new trustees and employees. This recommendation, although well intended, improperly places the burden on the DCRB/Executive Director to conduct criminal background checks.

To the extent criminal background checks are conducted for new Trustees, the Mayor, or the Council of the District of Columbia (who appoints half of the Trustees) should have responsibility for conducting any required criminal background check for their

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respective appointees. With respect to Trustees who are elected by employee groups the Board already provides notice of the requirement of 1-744 to potential candidates. The Board could take the extra step of requiring candidates to submit notarized statements that affirm they are eligible to serve as a Trustee consistent with prohibitions stated in § 1-744. This requirement would provide a legal affidavit for the file while maintaining the existing burden on the individual who wilfully violates § 1-744(a), consistent with the sanctions for violation of this provision under § 1-744(b).

For reasons earlier stated, the Board has limited responsibility to conduct criminal background checks for its staff other than those appointed to serve in a fiduciary capacity, to determine whether they have been convicted of any crime cited in § 1-744.

As also earlier stated, a criminal background check was indeed conducted for the current Executive Director, and the long history of continuous service as Board staff made such background checks unnecessary for the prior two Executive Directors

2. Conduct periodic checks, e.g., every two years, of incumbent fiduciaries and employees.

Given that the prohibition for serving as a fiduciary stated in § 1-744 expires 5 years after the conviction or release from incarceration, any Trustee and any staff person with fiduciary responsibility who has served for 5 consecutive years is automatically exempt from such background check as the 5-year prohibition period would have expired. Further, periodic checks every two years of incumbent trustees and other fiduciaries would be unnecessarily costly and burdensome and would not further the stated purpose of the prohibition under § 1-744.

3. Maintain adequate documentation to show criminal background checks have been conducted for the trustees and employees, and background checks have been conducted for the investment consultants and managers.

Adequate documentation for criminal background checks has been maintained for all fiduciaries with whom the Board has a duty to perform such criminal background checks.

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The Board's contracts require prospective investment managers and consultants employed by the Funds to submit a completed "Form ADV," which calls for extensive disclosure (including disciplinary information) regarding individual officers, directors, partners, or owners and serves as the investment adviser registration form with the SEC. The Board also requires these entities to submit any required amendments to Form ADV. Failure to update Form ADV may result in disciplinary, administrative, injunctive, or criminal action against the investment adviser by the SEC and/or a state. This documentation is available upon request.

Given the extensive Federal disclosure requirements and other laws, regulations, procedures, and regulatory enforcement efforts designed to protect investors, criminal background checks beyond what Board staff currently conducts through Westlaw for investment managers and consultants would be an imprudent use of Fund assets.

Finding 2 - Financial Disclosure

The Revised Draft Report discusses an internal financial disclosure requirement established by the Board for certain members of the Board's senior staff, similar to the requirement imposed on Trustees, the Executive Director and the General Counsel by the Office of Campaign Finance. The Revised Draft Report incorrectly concludes that these senior staff persons have significant responsibilities including providing investment advice. No staff person provides "investment advice."

Background

The District of Columbia Campaign Finance Reform and Conflict of Interest Act of 1974, as amended (Conflict of Interest Act), and codified in pertinent part in D.C. Official Code § 1-1106.02, requires all public officials in the District (including Trustees of the Board, the Board's Executive Director and General Counsel) to file annual Financial Disclosure Statements for the prior calendar year with the D.C. Office of Campaign Finance (OCF), established within the D.C. Board of Elections and Ethics (BOEE). Under implementing provisions of this law, these disclosure statements are kept by BOEE in the custody of the Director for 4 years, or until a request for examination and audit has been made by any member of the BOEE and adopted by a recorded majority vote. An examination and audit of the disclosure statements may not commence until after the individual concerned has been given due notice and opportunity for hearing in closed session. D.C. Official Code § 1-1106.02(c).

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Internal Policy Adopted by the Board

During a regular meeting of the Retirement Board on April 2001, a motion was approved, with three abstentions, to require senior staff to file financial disclosure statements internally to be made "available for internal Trustee use only." The verbatim transcript of that meeting gives a clear indication of the Board's intent to implement a similar requirement on senior staff that is required of Trustees under the Conflict of Interest Act. Although no specific procedure was discussed for the examination and audit of the financial disclosure statements filed by senior staff, it is unmistakable that the intent of the Board was to have its General Counsel keep these documents in custody, as is the case under the procedures of the Board of Elections and Ethics, until there is a request for examination and audit by a Trustee.

In keeping with requirements of the Conflict of Interest Act, after such request by a Trustee, the Board would require a majority vote to conduct the examination and audit, and such examination could only commence after the concerned individual had been given due notice and opportunity for a hearing in closed session. The Revised Draft Report correctly notes that the Board's motion did not require a review of the disclosures to determine whether a conflict of interest existed.

Investment Advice

The Revised Draft Report asserts that the Executive Director, General Counsel, Chief Investment Officer and Director of Operations all have significant responsibilities including providing "investment advice." There is no support offered for this assessment. A review of the position descriptions for these positions, and/or an interview with any of these individuals would confirm that none of them provide investment advice.

The U.S. Department of Labor ("DOL") has issued regulations under Section 3(21) of ERISA defining *investment advice*. Under these regulations which give guidance for understanding the use of this term, *investment advice* is defined as: (1) providing advice as to the value of securities or other property, or making recommendations as to the advisability of investing in securities or other property; and (2) providing such advice (a) on a regular basis, (b) pursuant to a mutual understanding that the advice will serve as the primary basis for an investment decision and (c) individualized to the specific plan. Importantly, the regulations specifically require that advice be provided with respect to investments in securities or other property. There is no evidence and no basis from either the Position Descriptions or other daily functions to suggest that any member of the senior staff provides

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investment advice.

Recommendations

We recommend that the Executive Director, DCRB:

4. Pursue adoption of an amendment to the Board's rules requiring executive staff to annually complete the OCF Financial Disclosure Statement, and
5. Establish procedures to ensure disclosure statements are properly and timely reviewed for possible conflicts of interests.

The Board has referred the Board's rules to its Operations Committee for a comprehensive review during the coming months. This process is conducted periodically and will result in recommended language to, among other things, clarify and incorporate the Board's internal policy for senior staff financial disclosure statements. During this process, the Board will also develop implementing procedures for its review of the financial disclosure statements which will observe privacy rights and due process considerations for concerned individuals.

FINDING 3 - CREDIT CARD LIMITS

The Board established its current procurement and travel card program at the end of 2001 and received the first credit card in 2002. The Board participates in the Smartpay Government Card of the U.S. General Services Administration. The Report of the OIG contains a misunderstanding of the limits the Board has placed on the travel and procurement cards. The Board believes that significant checks, balances, and controls are in place under this program to protect the cards from misuse and to limit the exposure of the Board in the case of theft or loss of an individual card.

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Recommendations

We recommend that the Executive Director, DCRB:

6. **Establish travel and procurement credit card limits based on the actual and anticipated yearly usage rates.**

OIG has recommended that the Executive Director establish travel and procurement card limits based on the actual and anticipated yearly usage rates. This had already been done. Fiscal 2003, the year of the OIG report, was a start up year and an estimate was used for predicted use. Current limits reflect actual and anticipated use based on the approved budget.

The Board's credit limit under the procurement card is \$75,000, i.e., the sum of the individual credit limit of all credit cards may not exceed the Board's credit limit of \$75,000. Currently, the Board has one procurement credit card, and the credit card has a credit limit of \$5,000. This is significantly below the total budget for supplies and materials which could be potentially paid for through authorized use of the card. The FY 2005 budget for supplies and materials is (comptroller source group 20) is \$160,000 and the proposed FY 2006 budget is \$256,783. Actual charges to the procurement credit card in fiscal year 2004 were \$25,206.

As for the travel card, it is again important to distinguish between the limit on the overall agency travel account and the limit for any individual travel card. The current limit of \$250,000 which the OIG observed for the travel card account is the Board's credit limit, i.e., the sum of the individual credit limit of all credit cards may not exceed the Board's credit limit of \$250,000. This is a level that would allow the Board to issue additional credit cards in the most practical and efficient manner. No where near this amount could actually be charged on any card. The limit for any individual card is based on the type of user. The current credit limits by credit card user type are: (1) Travel Coordinator (staff person who make travel arrangements for Trustees and staff) - \$10,000 credit limit, (2) Trustee - \$7,500 which is their individual education and travel budget, (3) Board Chairman and Investment Committee Chairman - \$10,000 which is their education and travel budget, and (4) staff - \$5,000. The current sum of the credit card limits for issued credit cards is \$27,500 - \$10,000 for one Travel Coordinator card, \$7,500 for one Trustee card, and \$10,000 for two staff cards with individual credit limits of \$5,000.

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MANAGEMENT RESPONSE

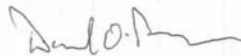
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An additional safeguard that is in place is a control by MasterCard merchant category code (MCC). This is a control whereby only certain specific categories of merchants can place charges against a credit card. The procurement and the travel card programs each have a list of valid MCC codes that may be used to place a charge against a credit card. The authorized MCC codes for the travel cards include airlines, Amtrak, hotels, restaurants, and taxi/shuttle fares. Attempted charges by another category of merchant, for example a retail store, are automatically declined. The procurement card program excludes certain MCC codes, for example the MCC for telemarketers is not allowed. The cards have been set up so that they are not able to be used at an ATM or other cash dispensing. The Director of Operations also downloads and checks a declined authorizations report for the cards every month. This provides an additional internal control.

In addition, the total agency limit of \$250,000 for the travel card program account already is below the total education and related travel for the agency. The fiscal 2004 budget for education and related travel was \$256,000; the budget amounts for 2005 and 2006 are \$272,000 and \$432,172 respectively.

In addition to the card limits and MCC code controls, the Board has in place a good system of checks and balances on card use. Use of the procurement card must be specifically authorized when a requisition is made for a supply or service. A log is kept of each charge at time of order. Three different individuals review the procurement card and travel card bills every month and verify each charge before payment.

Sincerely,



Darrick O. Ross
Chairman